



Tennessee Valley Authority

FY 2006 Rate Review

TVA Board Meeting - February 13, 2006

Michael E. Rescoe
Chief Financial Officer



Forward-Looking Statements

This document contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions, assumptions or otherwise relating to future events or performance may be forward-looking. In certain cases, forward-looking statements can be identified by the use of the words such as "may," "will," "should," "expect," "anticipate," "believe," "intend," "project," "plan," "predict," "assume," "estimate," "objective," "possible," "potential," or other similar expressions.

Some examples of forward-looking statements include statements regarding TVA's projections of future power and energy requirements; future costs related to environmental compliance; impacts of potential legislation on TVA and the likelihood of enactment of such legislation; strategic objectives; anticipated availability of nuclear waste storage facilities; projections of nuclear decommissioning costs; and impacts of pending litigation and various administrative orders which have been or may be issued.

Although TVA believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws, regulations, and administrative orders, especially those related to the restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA's generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; changes in accounting standards; and unforeseeable events. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA's business or cause results to differ materially from those contained in any forward-looking statement.

TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur after the statement is made.

FY 2006 Income Statement

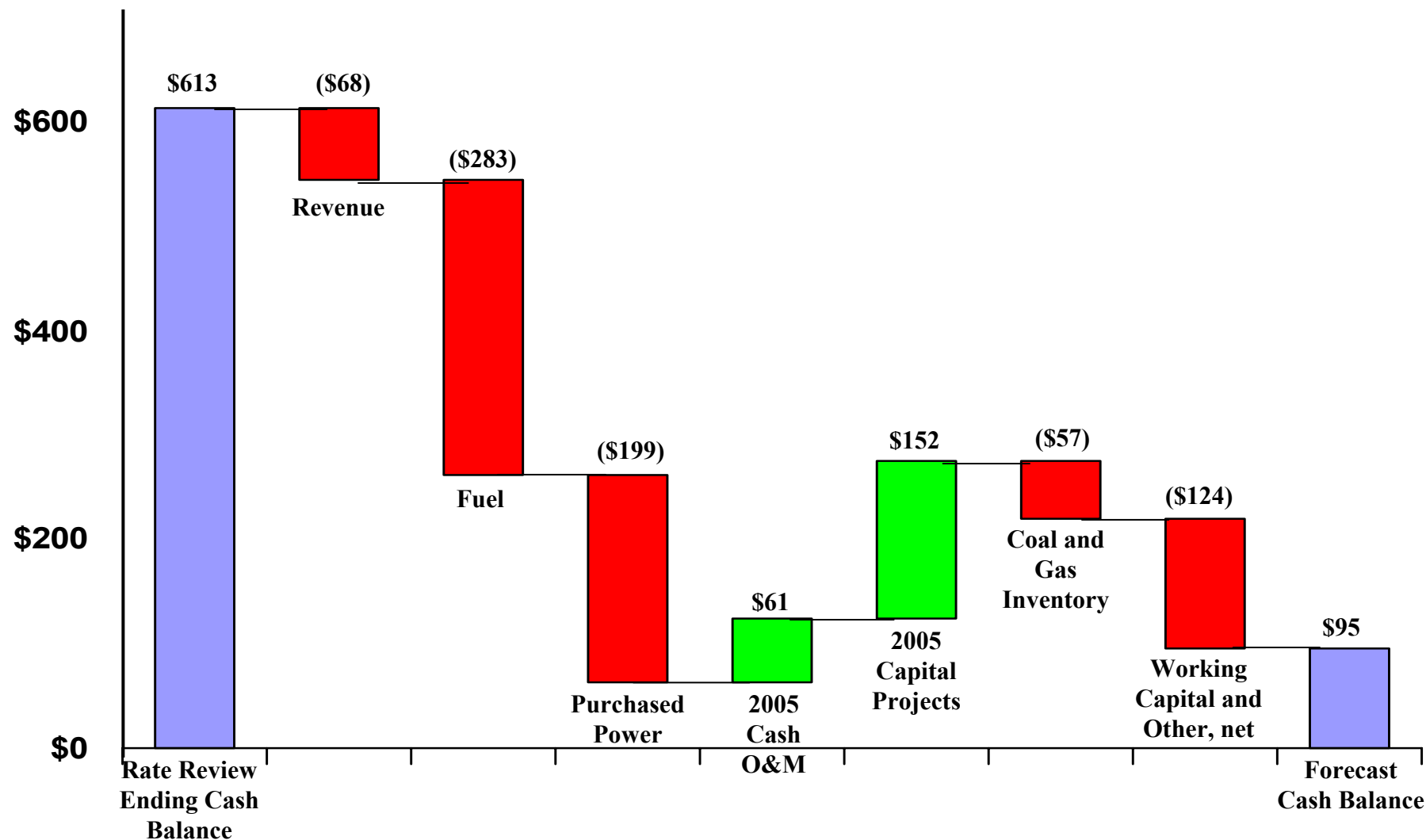
Rate Review versus Current Forecast

(in millions)	<u>2006 Rate Review</u>	<u>2006 Forecast</u>	<u>Variance</u>
Revenue	\$ 8,715	\$ 8,674	\$ (41)
Fuel & Purchased Power	(2,856)	(3,190)	(334)
Gross Margin %	67.2%	63.2%	
Operating, Maintenance & Other	(2,426)	(2,430)	(4)
Depreciation & Amortization	(1,591)	(1,581)	10
Tax Equivalents	<u>(375)</u>	<u>(375)</u>	<u>-</u>
Total Operating Expenses	<u>(7,248)</u>	<u>(7,576)</u>	<u>(328)</u>
Operating Income	1,467	1,098	(369)
Operating Margin %	16.8%	12.7%	
Other Income	34	35	1
Interest Expense (net)	<u>(1,288)</u>	<u>(1,256)</u>	<u>32</u>
Net Income	<u>\$ 213</u>	<u>\$ (123)</u>	<u>\$ (336)</u>

Changes in FY 2006 Ending Cash

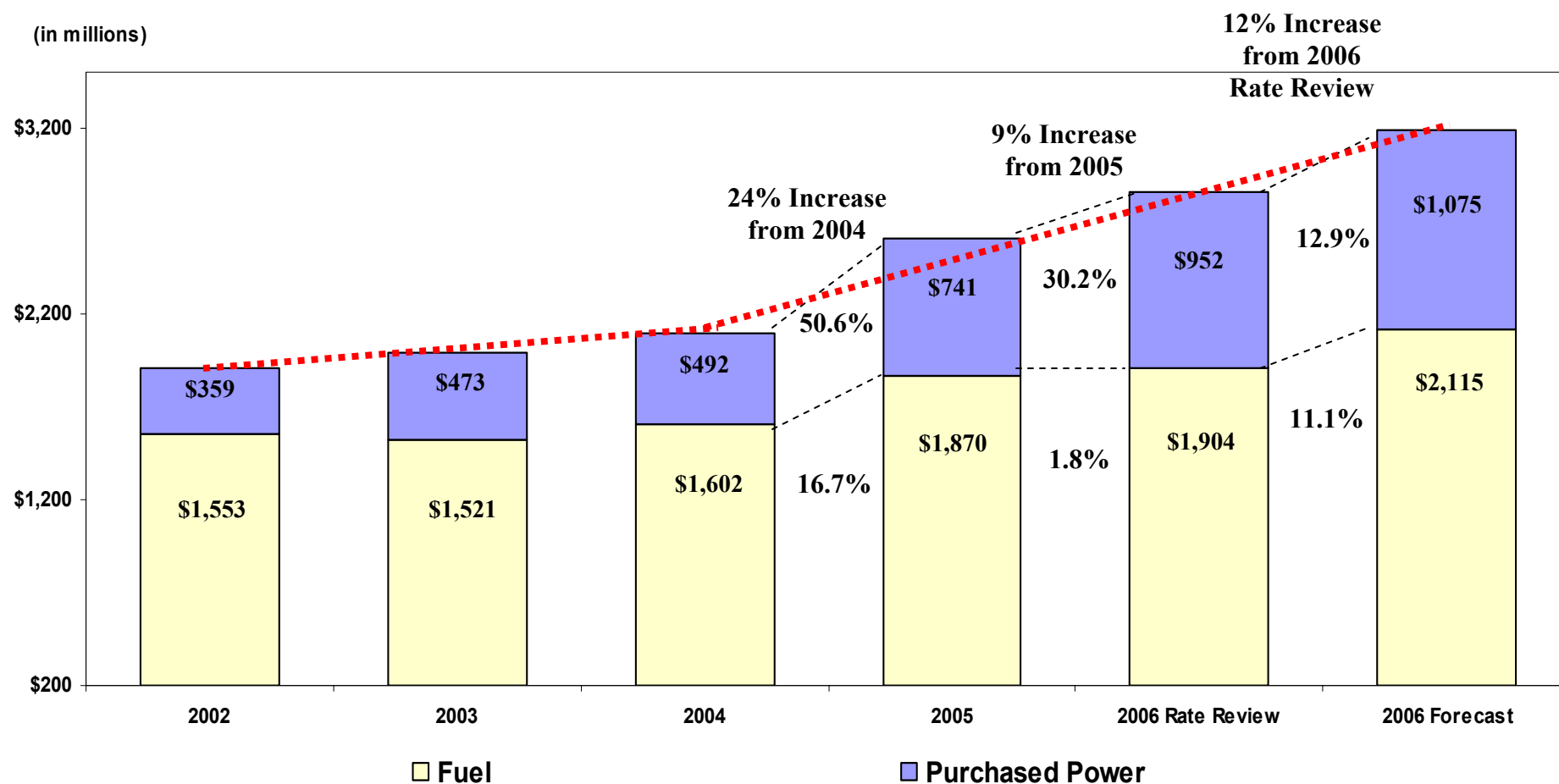
Rate Review Cash Balance versus Forecast Cash Balance

(in millions)



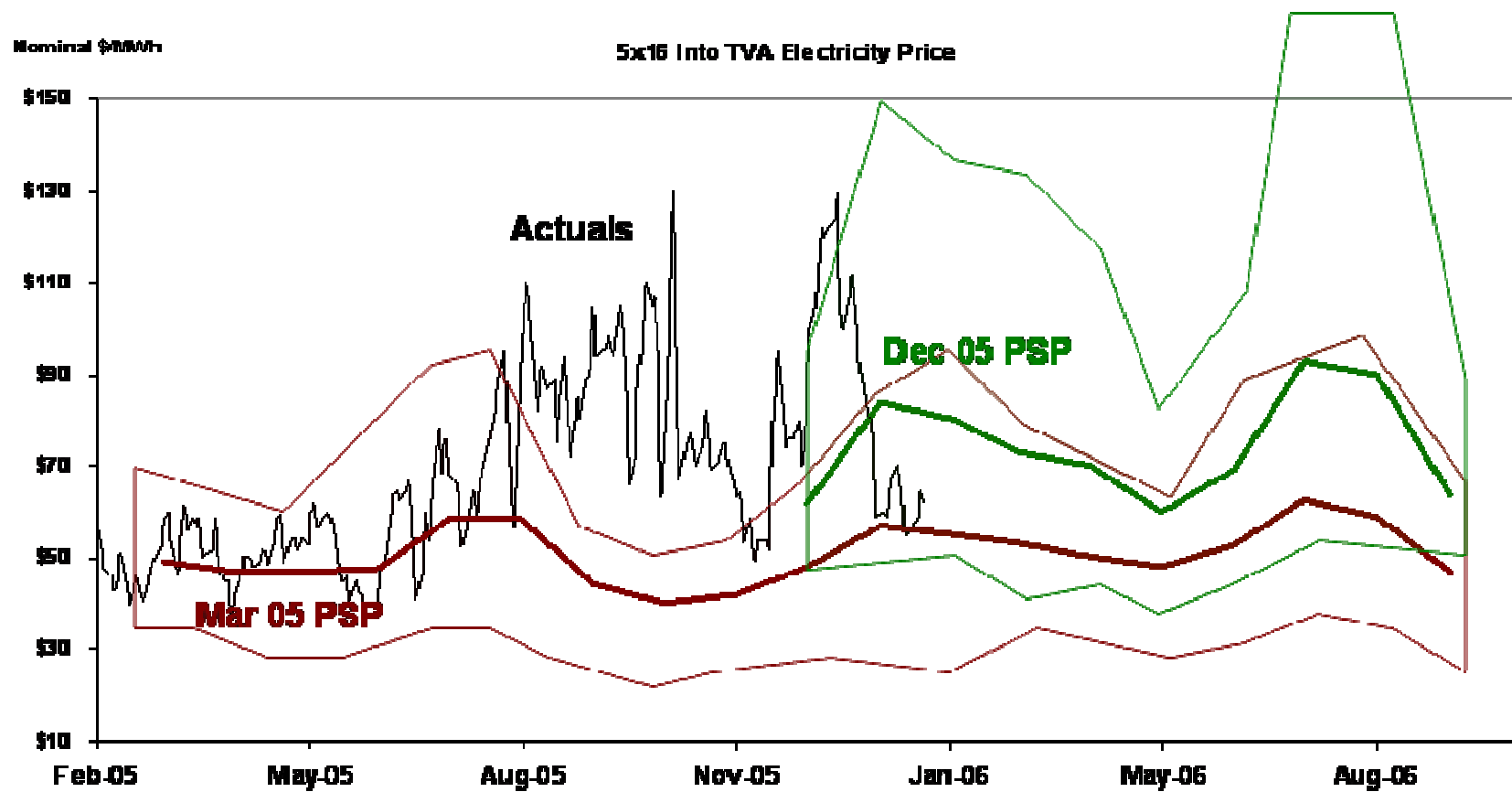
Total Fuel & Purchased Power Expense

Current forecast reflects significant and rapid increases in non-controllable power supply costs.





Higher Electricity Prices Have Contributed to the Increase in Purchased Power Costs



Source: **Actuals** – Power Markets Weekly Daily Spot Price

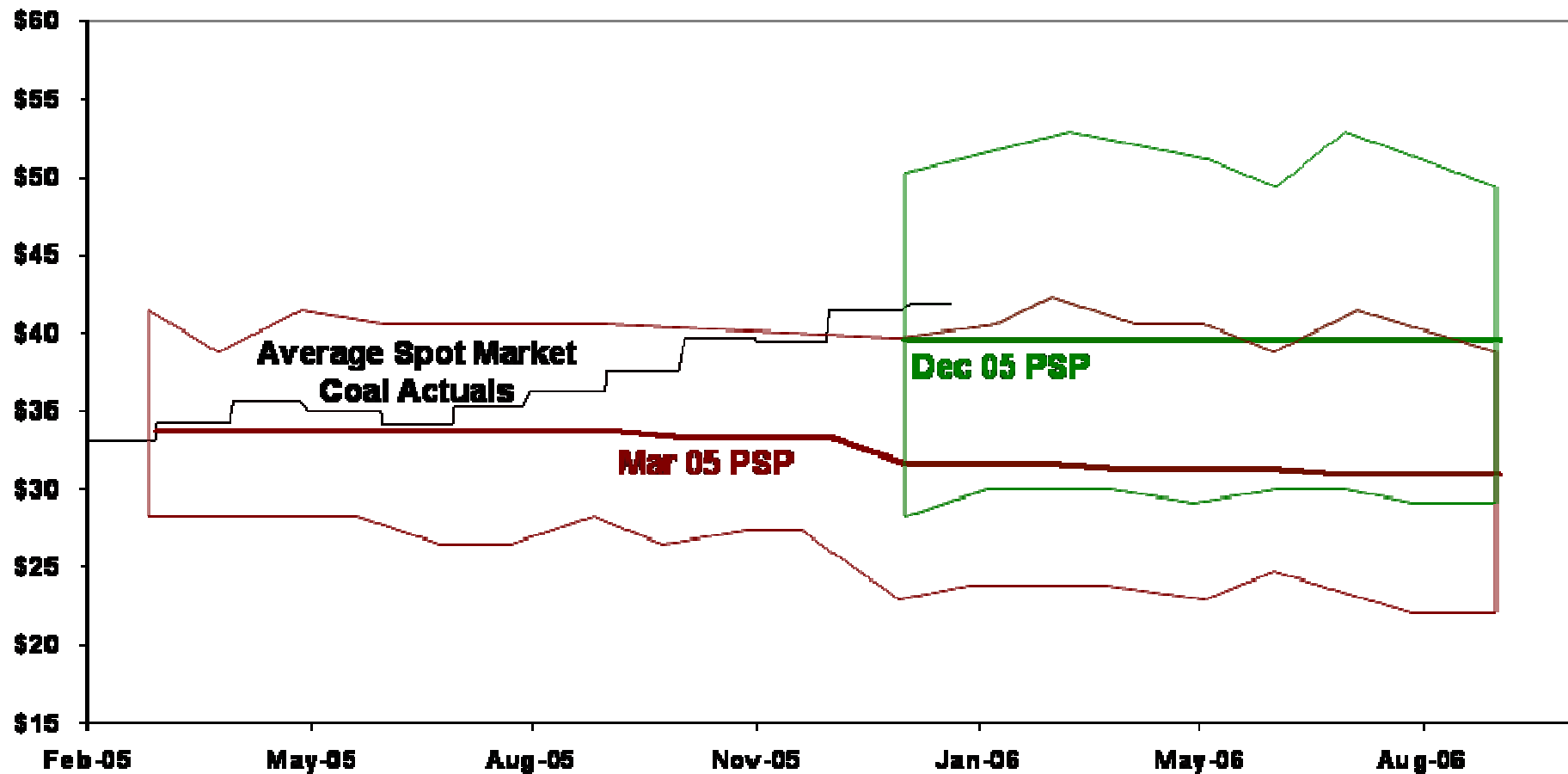
Forecasts – Average of ICE & AMEREX Brokers Forwards & Options on 02/02/05 (Mar 05 PSP)
11/02/05 (Dec 05 PSP)



Higher Spot Coal Prices Have Contributed to the Increase in Fuel Expense

Nominal \$/Ton

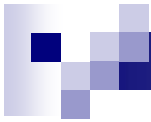
Average Coal FOB Mine Price



Average Price = Equally weighted by Basin

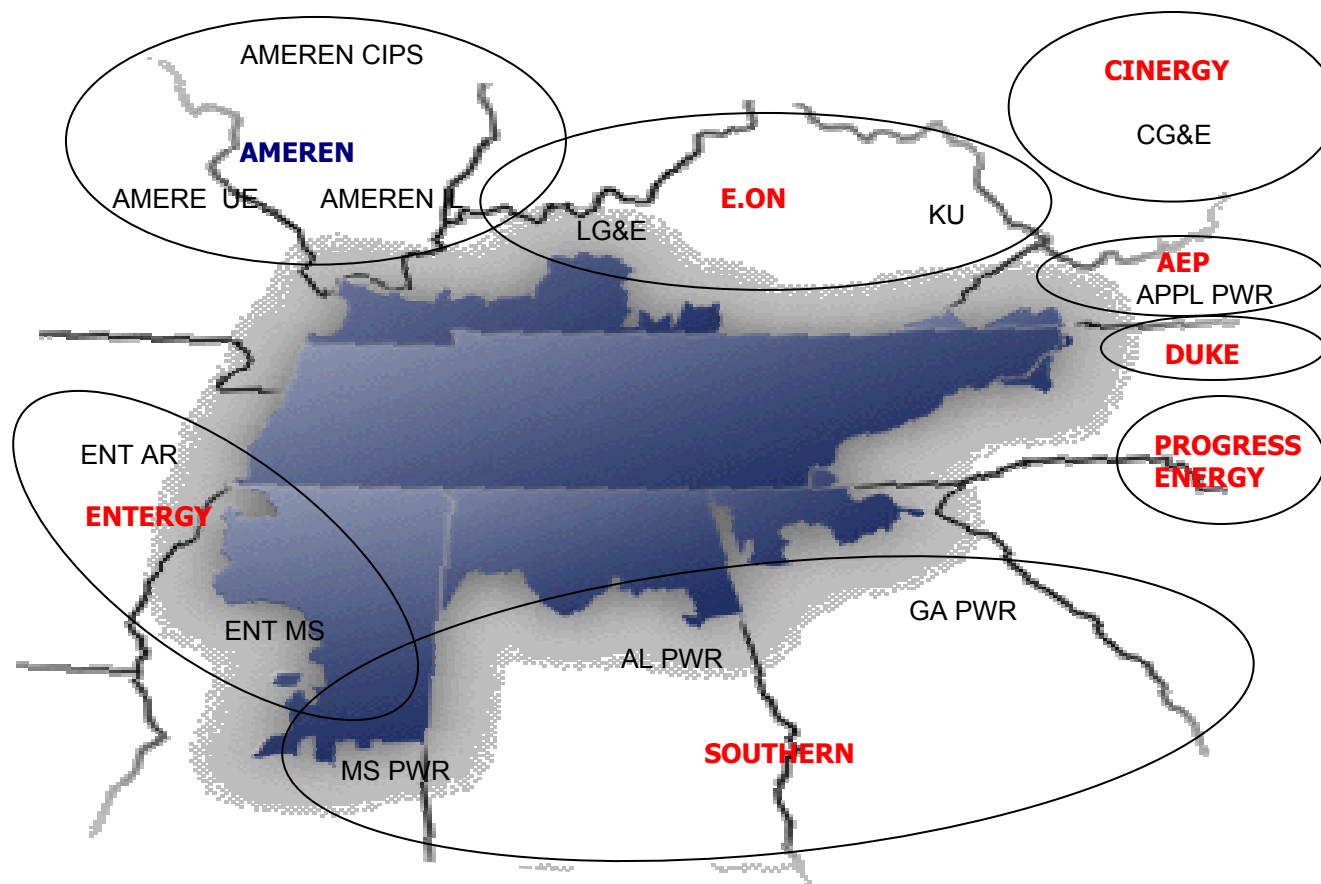
Source: **Actuals** – Argus Coal Daily End of Month Price

Forecasts – Argus Coal Daily Prices on 02/02/05 (Mar 05 PSP) 11/02/05 (Dec 05 PSP)

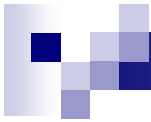


How Do Other Utilities Manage Power Cost Volatility?

Neighboring Utilities with Fuel Cost Adjustments

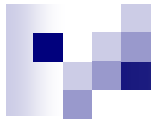


Red – Indicates utilities with fuel cost adjustment



Fuel Cost Adjustment (FCA) Objectives

- Provides a mechanism to mitigate cash flow impacts related to the volatility of fuel and purchased energy costs.
- Provides a timely and efficient pass-through of non-controllable costs for TVA and Distributors.
- Aligns actual fluctuations in costs with price signals to ultimate consumers.
- Mitigate financial risk for TVA and improve the credit profiles of TVA and Distributors.
- Monitor the FCA results on a quarterly and monthly basis beginning with July 2005.
- Pursue a Fuel Cost Adjustment in conjunction with the FY 2007 rate review and budget process.



FY 2006 Revenue Requirements

Rate Review Current Forecast

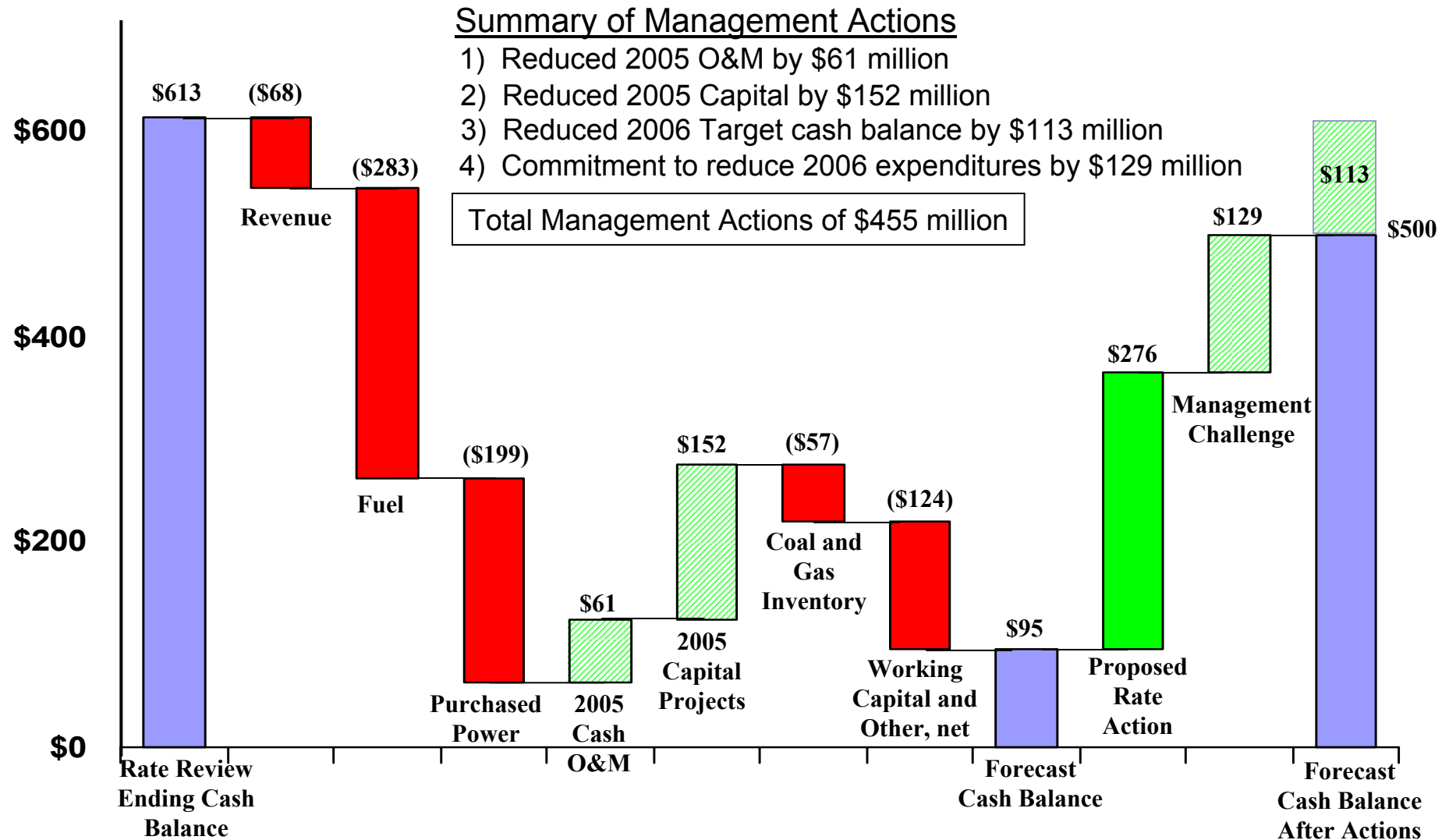
	FY 2006	FY 2006	
Fuel and Purchased Power	2,856	3,190	
O&M, Net of Non Cash Items	2,158	2,172	
Taxes	375	375	
1 Total Cash Operating Expenses	5,389	5,737	
Investing and Debt Service			
Cash Interest Expense	1,376	1,361	
Statutory Debt Reduction	200	200	
Reduction in Other Financing Obligations	140	140	
Capital and Other Cash Expenditures:			
Capital Investment	1,334	1,322	
Nuclear Fuel Fabrication	75	78	
Other Cash Requirements	201	241	
Subtotal Capital and Other Cash	1,610	1,641	
2 Total Debt Service Coverage	3,326	3,342	
1 + 2 Base Revenue Requirements	8,715	9,079	Proposed
Forecasted Revenue	8,191	8,674	8,674
Revenue Collection Shortfall	(524)	(405)	(276)

\$129

Changes in FY 2006 Ending Cash

Rate Review Cash Balance versus Forecast Cash Balance

(in millions)





Rate Review Summary

1. Address projected cash shortfall by proposing an increase to all firm wholesale rates in an amount estimated to collect \$276 million in fiscal year 2006
2. Mitigate further cash shortfalls by reducing remaining capital and O&M spending in 2006
3. Address future volatility in fuel and purchased power costs by pursuing a Fuel Cost Adjustment



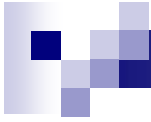


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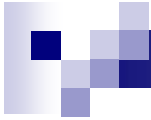
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Kenneth Breeden
Executive Vice President
Customer Service & Marketing



Fuel Cost Adjustment Considerations

- TVA worked closely with customers to develop the Fuel Cost Adjustment
- There is strong customer support and recognition of the need for an FCA
- There is value in testing the FCA formula prior to implementation on a date certain



Request for Board Approval

1. TVA Management requests the TVA Board approve effective April 1, 2006 an increase to all firm wholesale rates of 9.95%
2. It is also proposed that the Board determine that a Fuel Cost Adjustment is the appropriate structure for adjusting TVA's rates to reflect changing fuel and purchased power costs beginning in FY 2007

